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TAX AND WEALTH ADVISOR ALERT: IRS SAYS EXPENSES PAID WITH FORGIVEN PPP LOANS NOT DEDUCTIBLE

Yesterday, the IRS released guidance in Notice 2020-32 stating that expenses related to forgivable loans through the Paycheck Protection Program (PPP) will not be tax-deductible.

Under the PPP, a program created by the CARES Act to provide coronavirus relief, small businesses can receive forgivable loans of up to $10 million as long as the loan goes to essential expenses, such as maintaining payroll, rent, utilities, and mortgage interest.

While it was clear from the CARES Act that PPP loan forgiveness is not taxable income, the CARES Act said nothing about deducting the expenses paid with such loan proceeds. However, the IRS stated in its guidance yesterday that expenses that result in forgiveness of a PPP loan are not tax-deductible—thereby preventing a double tax benefit. This means that small businesses cannot claim tax deductions for expenses that are normally *fully* deductible, such as wages, rent, utilities, etc., if they are paid with PPP funds that are forgiven.

The IRS cited Section 256 of the tax code in its guidance, which states that deductions cannot be taken if they are tied to a certain class of tax-exempt income. If desired, Congress could override the IRS's stance by passing a law that explicitly allows the deductions. Additionally, it is possible a taxpayer may decide to challenge this position in court.

Nevertheless, given the current IRS guidance, small businesses that manage to get their PPP loans forgiven may find themselves losing valuable tax breaks and should plan accordingly.

O'Neil, Cannon, Hollman, DeJong and Laing remains open and will continue to monitor federal and state law tax changes. For questions or further information relating to taxation under the CARES Act, please contact attorney Britany E. Morrison.

UPDATE: On May 5th, 2020, Senator John Cornyn (R-Tex.) recently introduced the bipartisan Small Business Expense Protection Act (S. 3612), which moves to essentially nullify Notice 2020-32. Senate Bill 3612 provides that business expenses otherwise deductible under Code Section 162 would still be deductible even if they were funded by forgiven PPP loan proceeds.

Currently, the bill has picked up 23 sponsors. Neither Senator Ron Johnson nor Senator Tammy Baldwin have yet to express support. Nevertheless, this bill is strongly supported by the American Institute of Certified Public Accountants (AICPA). It was read twice in the Senate and referred to the Senate Committee on Finance but has been sitting there since. On May 12th, 2020, the House introduced an identical bill (HB6821) and referred it to the House Committee on Ways and Means. It has been sitting with the House Committee on Ways and Means since referral. The attorneys at O'Neil, Cannon, Hollman, DeJong and Laing will continue to monitor the status of both bills and provide information on any federal and state law changes.